

THE SECRETARY OF STATE
WASHINGTON

July 12, 1975

Dear Bill:

The Ways and Means Committee is considering that portion of the "Energy Tax and Individual Relief Act of 1974" dealing with foreign income. I have heard that the Administration is scheduled to testify before the Committee in early July.

One provision of the proposed legislation might be the taxation of allowances paid to government civilians serving overseas. This is of great concern to me since taxation of overseas allowances would have serious implications not only for the Department of State, but for all other government agencies with civilian employees serving abroad. If we are to retain the flexibility we need in the personnel administration of our overseas operation, we must insure that our personnel are not financially disadvantaged through the taxation of allowances which represent reimbursement to them for the unusual costs associated with their overseas assignments. Such allowances cannot and should not be considered incremental income to employees.

The Overseas Differential Act of 1960 (P.L. 86-707) which authorizes most of the overseas allowances in question, and the House and Senate Reports on that Act, clearly show Congressional recognition that service abroad entails expenses to employees above those which the employees would incur were they stationed in the United States. There has never been any intention to give overseas employees advantages over their colleagues who serve at home, but rather to treat them equally. I know that many misconceptions exist, both in and out of government, as to the true nature of overseas allowances and benefits. Where unbalanced treatment exists, I believe we are well on the way to correcting it and reestablishing a firm and clearly justified basis for the allowance program. I do not think these imbalances in application of law or regulation justify treating allowances as incremental income, however.

The Honorable
William E. Simon,
Secretary of the Treasury.

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An Inter-Agency Committee on Allowances and Benefits is currently reviewing the existing structure of federal civilian overseas allowances and benefits to arrive at recommendations on a comprehensive allowance program which would, effectively and equitably, meet current requirements for overseas operations.

Since the treatment of allowances for tax purposes is an essential element of the entire allowance structure, all committee members were asked to comment on the proposed repeal of Section 912 of the Internal Revenue Code. There was general agreement that consideration of any change in the present tax treatment of allowances should await completion of the current inter-agency review, and that a flat repeal of Section 912 at this time would be grossly inequitable, prejudicial to the operations of foreign affairs agencies, and without significant benefits to overall U.S. Government operations.

I think a brief review of some of the more significant overseas allowances will show why it would be inappropriate to subject them to taxation. The essential feature of each of these allowances is that it is intended to defray necessary additional expenses incurred because of overseas service. With the exception of the hardship differential paid to employees at unhealthy, dangerous or otherwise less desirable posts, which is currently subject to taxation, none of the allowances are classified as "premium" allowances.

-- The cost-of-living allowance is simply an equalizer designed to offset the difference between the cost of living at an expensive foreign post of assignment and in Washington, D.C. It is not realistic to expect employees to pay additional taxes because prices are higher in some parts of the world. For example, the cost of living for U.S. Government civilian employees in Geneva is 54% higher than Washington; in Kuwait 30% higher; in Yaounde 46% higher; and in Caracas 14% higher.

-- An education allowance is authorized so that all parents employed by the Government overseas can provide their children with the level of education which is available to all children free in the United States. Clearly this is not incremental income and not properly taxable.

-- The quarters allowance is also an offset against extraordinary housing expenses which an employee encounters as a direct result of his assignment in a foreign country. The average yearly cost of rent and utilities for a typical government employee between 1974 and 1975 rose by \$1,974 in Copenhagen, \$314 in Ankara, \$2,075 in Beirut, \$1,953 in Geneva, \$596 in Lima, and \$114 in Bangkok. With shortages of adequate housing and spiralling rent and utility costs at most foreign locations, the quarters allowance continues to be necessary to assign the right person to the right post at the right time.

I recognize that there are differences of opinion as to whether this last allowance includes an element of additional compensation and if so, whether it is justifiable. In my opinion if an employee overseas is advantaged by this allowance we should examine the method of computing the allowance and attempt to correct it rather than act precipitously to tax the quarters allowance. In this connection I am confident that the Inter-Agency Committee composed of senior officers from twenty government agencies will thoroughly study the problems and recommend remedies designed to achieve the results that we all seek.

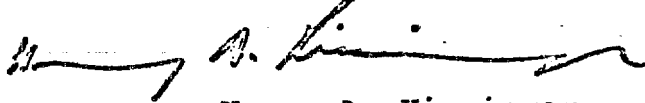
It has been suggested that it is necessary to tax the allowances of government civilians overseas because we want to treat them in the same manner as employees of private industry overseas. I do not believe that repeal of Section 912 will contribute toward equal treatment, when the conditions under which each group serves are vastly different in so many ways. No more should we suggest that taxation of military allowances and benefits would constitute equal treatment for civilian and military personnel. It must be recognized that we are dealing with three vastly different groups with different reasons for being overseas, needs and responsibilities. That fact alone argues for the need for separate treatment and different procedures to meet the specific needs of each group.

For all these reasons, I believe that the Administration's position before the Ways and Means Committee should be to recommend that allowances not be taxed, and that correction of deficiencies in the program be left to the Administration through the Inter-Agency Committee on Overseas Allowances and

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Benefits for U.S. Employees which would keep the Congress informed of the progress of its work. I am sending a similar letter to Jim Lynn expressing my thoughts on this subject. I hope that both of you will agree with my very strong recommendations regarding the Administration's position on this issue.

Warm regards,

A handwritten signature in dark ink, appearing to read "H. A. Kissinger", with a long, sweeping horizontal stroke extending to the right.

Henry A. Kissinger